# In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 71-1514

SOL BERGER, PETITIONER

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE UNITED STATES IN OPPOSITION

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A-1 to A-6) is not yet officially reported. The opinion of the district court (Pet. App. A-10 to A-26) is reported at 325 F. Supp. 1297.

### JURISDICTION

The judgment of the court of appeals (Pet. App. A-7) was entered on March 29, 1972. The petition for a writ of certiorari was filed on May 19, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).



471-070—72——1

## QUESTION PRESENTED

Whether there is sufficient evidence to support the finding of the district court that petitioner acted willfully with intent to defeat and evade the income tax liability of his controlled corporation in causing it to take improper tax deductions for manufacturing costs which were expenses of a wholly owned subsidiary.

## STATUTES INVOLVED

26 U.S.C. 482 is set forth at Pet. App. A–29.

26 U.S.C. 7201 provides as follows:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

## STATEMENT

After a bench trial in the United States District Court for the Southern District of New York, petitioner was convicted of having willfully attempted to evade income taxes owed for the years 1962, 1963 and 1964 by the Colonial Corporation of America, in violation of Section 7201 of the Internal Revenue Code of 1954 (R. 21a, 24a–25a).[1] Petitioner was sentenced to concurrent prison terms of eighteen months on each count, with the conditions that he be confined

[1] "R." references are to the appendix in the court of appeals.

in a jail-type institution for three months, that execution of the remaining prison sentence be suspended, and that he be placed on probation for a period of one year commencing upon expiration of confinement. The court of appeals affirmed (Pet. App. A–1 to A–6).

Petitioner was chief executive officer of, and a controlling shareholder in, Colonial Corporation of America ("Colonial"), a manufacturer of wearing apparel (Pet. App. A–1, A–12). In 1959, Colonial organized a foreign subsidiary, Colonial Shirts of Jamaica, Ltd. ("Jamaica") in order to take advantage of the permanent exemption which such a corporation would enjoy from United States income taxes. Jamaica manufactured shirts and sold its entire production to Colonial (Pet. App. A–2, A–12).

For purpose of the United States customs duties imposed on Jamaica's sales to Colonial, the corporations established a price equal to the shirts' "constructed value" (R. 486a–487a, 488a). See 19 U.S.C. 1401a. The price so determined was based on manufacturing costs and included an allowance of a reasonable profit to Jamaica. This price was substantiated by Colonial and approved by a United States Customs Examiner. Jamaica thereafter billed Colonial at this price (R. 569a).

The district court found that, beginning in 1959 or 1960, and at petitioner's express direction, the head bookkeeper of Colonial caused some of the invoices for piece goods shipped and invoiced to Jamaica to be entered in Colonial's purchase journals and paid by

Colonial; quarterly reports of such entries and payments were made only to petitioner. The substance of this practice was that Colonial was thereby paying a portion of Jamaica's expenses, amounting to between $50,000 and $75,000 per quarter; the effect of these payments was that Colonial claimed a business expense which in fact was attributable to Jamaica, a corporation not subject to federal income tax.

The district court accepted as true the testimony of Colonial's production chief and accountants that this practice of having Colonial make payments directly to Jamaica's suppliers was not known by or disclosed to them. The district court disbelieved the testimony of petitioner, who denied instructing the bookkeeper in this practice and testified that his fellow officers agreed to these manipulations in order to insure a "fair profit" to Jamaica (R. 1264a, 1353a; 1239). (Pet. App. A–5 to A–6, A–13, A–22 to A–26.)

These payments reduced Colonial's reported income tax liabilities in the amounts of $152,954.71, $123,065.09, and $191,417.77 for 1962, 1963 and 1964, respectively (Pet. App. A–13; R. 1815a). The district court held that these payments were not properly deductible as expenses of Colonial (Pet. App. A–18), and the court of appeals affirmed.

## ARGUMENT

1. There is no merit in petitioner's contention (Pet. 5–15) that Colonial was entitled to pay, and to claim tax deductions for, Jamaica's costs by virtue of Section 482 of the Internal Revenue Code of 1954. Petitioner did not testify that he acted in good faith

reliance on Section 482, or that he was even aware of it, but claims (Pet. 8) that his shifting of purchase costs from Jamaica to Colonial was a type of reallocation of expenses which is impliedly approved as a "safe haven" by Section 1.482–1(b) of the Treasury Regulations on Income Tax, 26 C.F.R. 1.482–1(b). Thus, despite his protestations (Pet. 12–13), it is he, not the government, who relies on Section 482. However, Section 482 can be invoked only at the instance of the government; use of Section 482 is not a matter of right to taxpayer. See, *e.g., Interstate Fire Insurance Co.* v. *United States,* 215 F. Supp. 586, 598 (E.D. Tenn), affirmed, 339 F. 2d 603 (C.A. 6).

The courts below (Pet. App. A–5, A–18 to A–19) found that the expenses in question were necessary expenses of Jamaica and that their "clandestine payment" (Pet. App. A–4) by Colonial could only properly constitute a loan or capital contribution to Jamaica, rather than a deductible expense of Colonial. This conclusion is consistent with the other facts in the case. The Colonial official responsible for negotiating the "constructed value," or price, testified (R. 522a–524a) that it was based on the "exact" cost of trim and a "very accurate" cost figure for piece goods and, while taxpayer testified that he used the "smallest possible profit" figure, it was noted by the courts below that Jamaica's resultant profits, which varied from 6 to 13 percent of sales during the years in question, were not "trifling" (Pet. App. A–3, A–14). The court below properly reasoned (Pet. App. A–3 to A–4, A–17 to A–18) that these findings made distinguish-

able the unusual situation where an expenditure by a parent corporation to preserve the viability of a subsidiary has been held an ordinary and necessary expense of the parent corporation.[2] Petitioner's case is therefore governed by the rule that a parent corporation cannot ordinarily deduct expenses incurred by its subsidiary. *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590.

As held by the district court (Pet. App. A–15 to A–16) and the court of appeals (Pet. App. A–3 to A–4), the correct tax liability of Colonial was fixed by the form in which it chose to cast its transactions in the relevant tax years and it is no defense to these criminal charges that petitioner might have arranged Colonial's transactions in those years so as to achieve a lower tax for Colonial. *United States* v. *Campbell,* 351 F. 2d 336, 340 (C.A. 2), certiorari denied, 383 U.S. 907; *United States* v. *Vardine,* 305 F. 2d 60, 64 (C.A. 2); *Clark* v. *United States,* 211 F. 2d 100, 105 (C.A. 8), certiorari denied, 348 U.S. 911.

2. Petitioner's contention (Pet. 16–20) that his conduct was not motivated by a desire to avoid taxes and was not willful was properly rejected by the district court (Pet. App. A–21 to A–26) and the court of appeals (Pet. App. A–5 to A–6). Such a determination by the district court is normally sustained if it is supported by evidence which is substantial when viewed most favorably to the government. *United States* v. *Sheiner,*

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[2] Of course, if Jamaica had required additional funds this could have been achieved through an increase in the constructed value. Presumably petitioner desired to keep this price low in order to minimize the 25 percent customs duty. See Pet. App. A–16 to A–17.

410 F. 2d 337, 340 (C.A. 2), certiorari denied, 396 U.S. 825; *United States* v. *Durant*, 324 F. 2d 859, 864 (C.A. 7), certiorari denied, 377 U.S. 906. As the court of appeals correctly summarized (at Pet. App. A–6):

> The government's independent evidence of willful affirmative acts beyond its proof of understated taxes, *Spies* v. *United States*, 317 U.S. 492, 499 (1943) included the following: (1) appellant directed Colonial's bookkeeper to remove Jamaica invoices in the amount of $50,000 to $75,000 each quarter for treatment as expenses on the books of Colonial; (2) he and only he received from the bookkeeper separate records which were kept of each false entry; (3) he concealed this procedure from all other top officers of Colonial, from Colonial's accountants and from its outside auditors. Appellant's denials not having been credited by the trial court, its finding of criminal intent beyond a reasonable doubt is amply supported by the evidence.

## CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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